

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

W. CRAIG HEYMANN,)	
)	DOCKET NO.: IT-2001-4
Appellant,)	
)	
-vs-)	FACTUAL BACKGROUND,
)	CONCLUSIONS OF LAW,
THE DEPARTMENT OF REVENUE)	ORDER and OPPORTUNITY
OF THE STATE OF MONTANA,)	<u>FOR JUDICIAL REVIEW</u>
)	
Respondent.)	

The above-entitled appeal was heard on April 17, 2002, in the City of Helena, Montana, in accordance with an order of the State Tax Appeal Board of the State of Montana (the Board). The notice of the hearing was duly given as required by law.

The taxpayer, W. Craig Heymann, presented testimony in support of the appeal. The Department of Revenue (DOR), represented by Income Tax Specialist, Jim McKeon, presented testimony in opposition to the appeal. Mr. Heymann is the appellant in this proceeding and, therefore, has the burden of proof. Based on the evidence and testimony, the Board finds that the decision of the Department of Revenue shall be affirmed.

STATEMENT OF THE ISSUE

Mr. Heymann opened a Montana First-Time Home Buyer Savings Account in August of 1998 and purchased his first home in November of 1998. Is Mr. Heymann entitled to a continuing exclusion on his 1999, 2000 and 2001 Montana individual income tax returns for amounts deposited in his Montana First-Time Home Buyer Savings Account?

FACTUAL BACKGROUND

1. Due, proper and sufficient notice was given of this matter, the hearing hereon, and of the time and place of the hearing. All parties were afforded opportunity to present evidence, oral and documentary.

2. The Board will include tax year 2001 with the present appeal, pursuant to a request made at hearing by both parties. The additional assessment for 1999, 2000 and 2001 is \$468.20, which includes penalty and interest charges.

3. By letter dated March 9, 2001, the DOR notified Mr. Heymann that it had adjusted his 1999 and 2000 individual income tax returns. As Mr. Heymann's 2000 return was being processed, an error resolution worksheet was generated showing that he had claimed a \$3,000 deduction as a reduction to income for the first-time home buyer's account.

4. Upon receipt of the error resolution worksheet, the DOR undertook an review to determine whether the \$3,000 reduction to income was allowable. In reviewing this error worksheet, the DOR reviewed prior returns in an attempt to determine if a home had been purchased prior to the year of the deduction.

5. In reviewing Mr. Heymann's prior year returns, the DOR found that Mr. Heymann had taken an itemized deduction for home mortgage interest in 1998 and 1999. This indicated to the DOR that a home had been purchased and that the first-time home buyer savings account deduction would be disallowed. Based on that information, the DOR retrieved the 1999 and 2000 returns and adjusted them.

6. On March 15, 2001, Mr. Heymann appealed this determination to the DOR. On May 31, 2001, Mr. McKeon provided Mr. Heymann with the legislative history that he had requested, together with an article from the Montana State University guide relating to the first-time home buyer account (DOR Exhibit A) and the DOR legal opinion regarding this issue. (DOR Exhibit A).

7. On June 6, 2001, the case was referred to the DOR's Office of Dispute Resolution for an informal hearing process.

8. It was decided by the DOR hearing officers that a conflict of interest existed due to the fact that Mr. Heymann is an employee of the Department of Revenue. Therefore, the Office of Dispute Resolution requested to be excused from the case and that a new hearing officer be assigned.

9. On August 2, 2001, DOR Director Curt Alme signed an order appointing Michele Crepeau, DOR tax counsel, as the hearing officer for this case. Ms. Crepeau did schedule a scheduling conference with Mr. Heymann and Mr. McKeon, which subsequently was postponed.

10. Eventually, the DOR issued a letter to Mr. Heymann stating that it had simply failed to respond to his request for an informal hearing within the statutory 180 days and that he had the right to appeal this to the State Tax Appeal Board.

11. Mr. Heymann appealed to this Board on November 8, 2001.

TAXPAYER'S CONTENTIONS

Mr. Heymann testified that, in 1997, the Montana State Legislature enacted House Bill 599, which provided for an exclusion from state income taxes for contributions to a savings account whose purpose is to finance the down payment

and closing costs associated with the purchase of a first home.

In accordance with that law, Mr. Heymann claimed a \$3,000 exclusion on his Montana individual income tax returns for tax years 1998 through 2001.

Mr. Heymann's position is that these carryover exemptions end when the deposited amount has been excluded, subject to the ten-year and \$3,000 per year limitation. He supports his position with the following:

Section 15-63-202 (4), MCA, which provides that . . . "each year an account holder may deposit into an account more than the amount excluded pursuant to subsection 2 if the exemption claimed by the account holder in a year does not exceed the amount specified in other sections. An account holder who deposits more than the amount specified in subsection 2, may exclude from the account holder's adjusted gross income in accordance Section 15-30-111, MCA, in a subsequent year, any part of the amount specified in subsection 2 (a) or 2 (b) per year, not previously excluded."

This is the basis under which Mr. Heymann has reduced his taxable income in years subsequent to 1998, the year in which he purchased his home.

Mr. Heymann opened a first-time home buyer account in August of 1998. In October of 1998, he purchased his first home. With the provision in the law that allowed contributions in excess of the \$3,000 annual limit, "he decided to take advantage and transferred \$18,000 from another savings account into a solely designated savings account for the purpose of buying a first-time home." (State Tax Appeal Board hearing, April 17, 2002)

In his view, he was allowed to carry over the \$3,000 from 1998 to 1999 to 2000 to 2001 until he had reached the amount of \$16,500, which he said was what he spent on closing costs.

Mr. Heymann testified that he undertook some research on House Bill 599, which took effect in January of 1998. He outlined the history of the bill and testified that he listened to and made notes of the legislative hearings at which this bill was discussed. Mr. Heymann noted that the hearing testimony made reference to issues such as who should qualify for this tax exclusion, who would administer the account and the law, should there be income limits, and who could contribute to the account, where the documentary burden would lie, and residency requirements. Mr. Heymann asserted that he could find no reference in either the Senate or the House hearings about when this carryover

provision would end in regard to an excess contribution in one year being carried over into subsequent years. Since he could find no provision in the law that the eligibility to claim excess contributions would end upon the first-time purchase of home, his view is that he can continue to exclude \$3,000 from adjusted gross income until he has exhausted his \$16,500 closing costs.

DOR'S CONTENTIONS

The DOR's position is that the carry over provision of Section 15-63-202 (4), MCA, regarding excess contributions to the first-time home buyer savings account end upon the purchase of the first home.

DOR Exhibit A contains a copy of the DOR's Statement of Account for tax years 1999, 2000 and 2001 showing additional assessments based upon the disallowance of the \$3,000 first-time home buyer exclusion taken by Mr. Heymann for those tax years. This document shows that the taxpayer owes a total of \$468.20, reflecting additional liability (\$388), penalty (\$38.54) and interest (\$41.66) for those three tax years.

The exhibit also contains a copy of the first-time home buyer savings account reconciliation sheet, which is required to be attached to the tax returns of those individuals claiming the subject \$3,000 exemption for single taxpayers. This form, in essence, is a reconciliation of

the deposits and withdrawals to the first-time home buyer savings account so that the DOR can verify the amounts of deposits and withdrawals for the purpose of purchasing a first home. In this case, Mr. Heymann deposited \$3,000 into the account in August of 1998 and \$14,000 on September 10, 1998 and an additional \$1,000 on September 23, 1998, for a total of \$18,000 within the two month period. Interest was earned in the amount of \$24 during that period. By statute, interest earned is also exempt and deductible from income for the purpose of the first-time home buyer's exclusion. Mr. Heymann withdrew \$1,500 on September 28, 1998 and made a final withdrawal of \$16,524 on October 1, 1998. Mr. McKeon testified that the DOR agrees with the information stated on this form as eligible deposits and withdrawals as Mr. Heymann did close on his home on October 2, 1998 and used \$16,500 from this account to pay the closing costs.

DOR Exhibit A contains copies of portions of the 1998, 1999, 2000 and 2001 returns for Mr. Heymann. The allowance for a single taxpayer to claim the \$3,000 annual deduction prior to the purchase of a first home is recorded on line 33 of Form 2. In 1998, Mr. Heymann deducted \$3,024 from on line 33 of Form, which includes the \$3,000 allowed by statute plus accrued interest on that account. Mr. McKeon also included a copy of the settlement statement completed

when Mr. Heymann purchased his home on October 2, 1998. The DOR has no disagreement with the costs associated with purchasing the home and associated withdrawals from the first-time home buyer savings account.

Mr. Heymann's 1999, 2000, and 2001 returns also show that Mr. Heymann deducted \$3,000 on each of those three returns filed in those years subsequent to the purchase of his home.

Mr. McKeon included excerpts from the legislative history of House Bill 599 in DOR Exhibit A. Mr. McKeon highlighted some areas he considered pertinent to the question of legislative intent. The sponsor's opening statement before the Senate Taxation Committee considering this bill in the 1997 legislative session stated: . . . "The hardest thing for most people to do is come up with down payments on a house; they can afford the monthly payments but not the down payment as a rule. . . ." Mr. McKeon testified that the DOR's position is that the key purpose of this legislation was to come up with a method to assist individuals who were having a difficult time making rental payments, and other payments, to be able to save money to come up with a down payment, over a period of years, to purchase a home. It was not intended for

individuals that had the ability of making a down payment to contribute money to take advantage of a tax deduction.

Section 15-63-102, MCA, contains definitions pertinent to the present appeal and the Montana First-Time Home Buyer Savings Account Act of 1997:

. . . (2) "Account holder" means an individual who is a resident of this state and who establishes, individually or jointly, a first-time home buyer's savings account. The account owner must also be a first-time home buyer. (Emphasis supplied.) . . .
(4) "First-time home buyer" means an individual who has never owned or purchased under contract for deed, either individually or jointly, a single-family residence in Montana or out-of-state.

Mr. McKeon agrees that Mr. Heymann did meet the definition of an account holder when he established a first-time home buyer's savings account in 1998 prior to the purchase of his first home. The DOR also agrees that Mr. Heymann met the definition of a first-time home buyer prior to the purchase of his first home in 1998. Therefore, the DOR has no problem with the exclusion from income of \$3,000 on the taxpayer's 1998 return for the first-time home buyer's deduction.

Section 15-63-202, MCA, provides for an exclusion from adjusted gross income:

(1) Except as provided in this section, the amount of principal provided for in subsection (2) contributed annually by an account holder to an account and all interest and other income on the principal may be excluded from the adjusted gross income of the account holder and is exempt from taxation in accordance with 15-30-111 (2) (k), as long as the principal and interest or other income is contained within the account or withdrawn only for eligible costs for the purchase of a single-family residence by a first-time home buyer.

In Mr. Heymann's case, the full amount contained within his first-time home buyer savings account (\$18,000) was withdrawn in 1998. Pursuant to the above statute (Section 15-63-202 (1), MCA), "as long as the principal and income is contained within the account ... for the purchase of a single-family residence by a first-time home buyer", the \$3,000 deduction for a single taxpayer may be taken. Therefore, only the 1998 deduction was legitimate as that was the only tax year in dispute in which the subject savings account was intact.

Section 15-63-202 (4), MCA, provides:

Each year, an account holder may deposit into an account more than the amount excluded pursuant to subsection (2) if the exemption claimed by the account holder in the year does not exceed the amount specified in subsection (2) (a) or (2) (b). An account holder who deposits more than the amount specified in subsection (2) (a) or (2) (b) into an account in a year may exclude from the account holder's adjusted gross income, in accordance with 15-30-111

(2) (k), in a subsequent year any part of the amount specified in subsection (2) (a) or (2) (b) per year not previously excluded.

The DOR's position is that Mr. Heymann was no longer an account holder after his purchase of his first home in 1998. Mr. McKeon emphasized that each year must be looked at separately. Once a taxpayer purchases the first home, he no longer meets the definition of an account holder and is no longer allowed the exemption. The carry over provision is provided, and allowed, as long as the individual remains as an account holder and has not purchased a home.

DOR Exhibit A contains a copy of a legal opinion issued by the DOR on March 5, 1999 addressing the first-time home buyer savings account. The questions presented by interested DOR personnel to its legal counsel were: (1) Can a taxpayer open a First-Time Home Buyer Savings Account after purchasing a home and claim the exemption? (2) If a taxpayer makes contributions to a First-Time Home Buyer Savings Account and those contributions exceed the amount excludable from Montana adjusted gross income, is there any limit as to the number of years in which the taxpayer may continue to exclude the income and claim the exemption? Mr. McKeon made reference to several points made within the memorandum: "The Montana First-Time Savings Account Act ("the Act"), provides that the tax advantages which attach

to an account terminate "at the time of purchase of a single-family residence. . . The purpose of the Act is to enable individuals to purchase their first home when they are otherwise unable to save enough money. *Minutes of House Taxation Committee, March 12, 1997; Minutes of Senate Taxation Committee, April 9, 1997.* For instance, people who rent single-family residences may be able to afford their monthly rent, but find it difficult to save enough money for a down payment on their first home. Thus, the Act was designed to help those who could not otherwise afford a down payment; it was not intended to help defray the cost of individuals who can obtain enough money for a down payment. Accordingly, the tax exclusion and exemption provided by the Act terminates on the date the taxpayers purchase their first home. . . The tax exclusions and exemptions provided by the First-Time Home Buyer Savings Accounts Act are subject to strict limitations. The tax advantages terminate at the earlier of: (1) the taxpayer's purchase of a first-time home; or (2) the expiration of the 10-year period that begins upon the opening of the account. Once either of these conditions have occurred, principal and interest remaining in the account ceases to qualify for special tax treatment. Instead, it is taxed as ordinary income." Mr.

Heymann purchased his first home in 1998. Therefore, the tax exclusion terminates in 1998.

DOR Exhibit A contains a copy of an article written by Marsha A Goetting, Profession and Extension Family Economics Specialist, Montana State University-Bozeman; and Cynthia Alexander and Scott Payton of the Montana Department of Revenue on the subject of the Montanan First-Time Home Buyer Savings Account. Mr. McKeon called the Board's attention to a hypothetical taxpayer situation discussed in the article: . . . "Once John purchases a home, he can no longer claim a carryover reduction for the portion . . . of the \$15,000 that he did not claim as a reduction in prior years. . ."

DOR Exhibit A contains a copy of a DOR Office of Dispute Resolution informal hearing decision concerning a taxpayer in a similar situation as the present taxpayer. In that decision, the hearing examiner concluded that "the tax exclusion terminates as of that date." (the purchase of a first home.)

Mr. McKeon analogized the position of Mr. Heymann regarding the carry over provisions of Section 15-63-202 (4), MCA, to that of a married couple, filing a joint return, (allowed a statutory \$6,000 tax reduction per year as account holders in a first-time home buyer savings account) who are able to put \$60,000 into such an account

one month prior to the purchase of their first home and then taking a \$6,000 reduction as a tax credit each year for the next ten years. The statute did not contemplate taxpayers who are otherwise able to come up with a down payment to receive such a tax advantage for ten more years.

BOARD DISCUSSION

The Board finds merit in the Department's position that Mr. Heymann did qualify in 1998 as a first-time home buyer and, therefore, was allowed the \$3,000 plus interest deduction. However, upon purchasing his first home in 1998, any subsequent deductions are not allowed by statute.

Therefore, the disallowance of 1999, 2000 and 2001 reduction of \$3,000 to adjusted gross income on his Montana individual income tax was proper.

The Board is convinced that the intent of the legislation relating to the first-time home buyer savings account, codified in Sections 15-63-201 through 15-63-205, MCA, was to assist first-time home buyer's in overcoming some financial hurdles inherent in purchasing a home and not to provide a lengthy tax break for those who could meet down payment and closing costs without this assistance.

The taxpayer's position in this matter is analogous to that of a hypothetical married couple buying their first home. They might inherit \$60,000, open a first-time home

owner's savings account one month prior to the purchase of their first home, pay cash for a \$60,000 home, and then, for nine years thereafter, deduct \$6,000 from their adjusted gross income on their Montana income tax returns. The Board is not convinced that this situation is in compliance with the intent of the statute.

CONCLUSIONS OF LAW

1. **§15-2-302, MCA. Direct appeal from department decision to state tax appeal board - hearing.** (2)(a) Except as provided in subsection (2)(b), the appeal is made by filing a complaint with the board within 30 days following receipt of notice of the department's final decision.

2. **§15-63-102 (2), MCA.** "Account holder" means an individual who is a resident of Montana and who establishes, individually or jointly, a first-time home buyer savings account. Additionally, the account holder must be a first-time home buyer. . . (Emphasis supplied.)

3. **§15-63-102 (4), MCA.** "First-time home buyer" means an individual who has never owned or purchased under contract for deed, either individually or jointly, a single-family residence in Montana or out-of-state.

4. **§15-63-202, MCA. Tax Exemption - conditions.** (2) (a) An account holder who files singly, head of household, or married filing separately may exclude as an annual

contribution in 1 year up to \$3,000. . . (4) Each year, an account holder may deposit into an account more than the amount excluded pursuant to subsection (2) if the exemption claimed by the account holder in the year does not exceed the amount specified in subsection (2) (a) or (2) (b). An account holder who deposits more than the amount specified in subsection (2) (a) or (2) (b) into an account in a year may exclude from the account holder's adjusted gross income, in accordance with 15-30-111 (2) (k), in a subsequent year any part of the amount specified in subsection (2) (a) or (2) (b) per year not previously excluded.

5. The appeal of the taxpayer is denied and the decision of the Department of Revenue is affirmed.

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ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the subject assessment is properly due and owing.

Dated this 29th day of April, 2002.

BY ORDER OF THE
STATE TAX APPEAL BOARD

(S E A L)

GREGORY A. THORNQUIST, Chairman

JERE ANN NELSON, Member

MICHAEL J. MULRONEY, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 29th day of April, 2002, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

W. Craig Heymann
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